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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA, WESTERN DIVISION

MANAGED PHARMACY CARE, a California corporation; INDEPENDENT LIVING CENTER OF SOUTHERN CALIFORNIA, INC., a California corporation; CALIFORNIA FOUNDATION FOR INDEPENDENT LIVING CENTERS, a California corporation; GERALD SHAPIRO, Pharm.D., doing business as Uptown Pharmacy & Gift Shoppe; SHARON STEEN, doing business as Central Pharmacy; TRAN PHARMACY, INC., a California corporation, doing business as Tran Pharmacy; ODETTE LEONELLI, Pharm.D., doing business as Kovacs-Prey Pharmacy; MARKET PHARMACY, INC., doing business as Market Pharmacy; and MARK BECKWITH

Plaintiffs.

-vs.-

KATHLEEN SEBELIUS, Secretary of the U.S. Department of Health and Human Services; TOBY DOUGLAS, Director of Department of Health Care Services of State of California; and DOES 1 through 50

Defendants.

CV11-9211 R (PJWx).

NOTICE OF MOTION FOR PRELIMINARY INJUNCTION AND FOR TEMPORARY RESTRAINING ORDER

Date: Dec. 19, 2011
Time: 10 a.m.
Court: 8:
Judge: Manuel L.Real

ADDITIONAL COUNSEL FOR PLAINTIFFS:

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TO THE DEFENDANTS KATHLEEN SEBELIUS, SECRETARY OF THE U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES (HEREIN, "THE SECRETARY"), AND TO DEFENDANT TOBY DOUGLAS, DIRECTOR ('HEREIN, "DIRECTOR") OF THE DEPARTMENT OF HEALTH CARE SERVICES OF THE STATE OF CALIFORNIA, AND EACH OF YOU:

PLEASE TAKE NOTICE that on December 19, 2011, at 10 a.m. in Courtroom 8 of the above-entitled Court, second floor, 312 N.. Spring Street, Los Angeles, |California, that the plaintiffs will move the above-entitled Honorable Court for the following orders:

1. That the Secretary vacate and set aside, and do all things to cause to be vacated and set aside, that certain order, decision, and action of the Centers for Medicare and Medicaid Services (:"CMS"), and of the Secretary, which approved and accepted the State Plan Amendment ("SPA") submitted by the Department of Health Care Services ("DHCS") of the State of California, to reduce payments by 10% prospectively from October 27, 2011, and retroactively to June 1, 2011, to all non-institutional providers in the Medi-Cal fee-for-service program, including pharmacies, and to also refrain from making an actuarial equivalent reduction in payment, or any reduction in payment to, Medi-Cal managed care plans; until the final determination of the within action; and,

2. That the Director, and all employees, agents, and servants of the Director, and all persons working in concert with him, refrain from implementing Assembly Bill 97, and from implementing any 10% payment reduction, or any payment reduction, to providers in the Medi-Cal fee-for-service program, including pharmacies; and to Medi-|Cal managed care plans, pending the final determination of the within action;

PLEASE ALSO TAKE NOTICE that the Plaintiffs hereby apply to the Court in and by this Notice of Application for Temporary Restraining Order, for a temporary restraining order which restrains the Director, his agents, employees and contractors and all persons working in

concert with him, from implementing Assembly Bill 97 or the 10% rate cut of AB97, or any payment reduction whatsoever or at all, to Medi-Cal providers, including pharmacies, in the Medi-Cal fee-for service program, or to any Medi-Cal managed care plan, pending the hearing of the within Preliminary Injunction motion, served and filed herewith.

PLEASE ALSO TAKE NOTICE that. Each of the above motions for preliminary injunction and applications for temporary restraining orders, shall be made and based upon:

- the Complaint, and any amended complaint filed herein;
- the declarations on file and served herein;
- the within notice of motions and notice of application for TRO;
- all the papers on file in the within case;
- all the papers in Case No. 09-cv-03315 CAS (MANx) and in Case No. 09-cv-0382 CAS (MANx) in the above-entitled Court;
- the below memorandum of Plaintiffs
- all the documents that are served upon you herewith.

EACH OF YOU SHALL ALSO TAKE NOTICE THAT IN RESPECT TO THE APPLICATION OF PLAINTIFFS FOR A TEMPORARY RESTRAINING ODER, THAT YOU HAVE UNTIL 24 HOURS AFTER SERVICE UPON YOU OF THIS NOTICE OF APPLICATION FOR TEMPORARY RESTRAINING ORDER, TO SERVE AND FILE ANY WRITTEN RESPONSE THERETO WITH THE COURT.

WHEREUPON, the Plaintiffs pray for the relief specified in this notice of motion for preliminary injunction, and this notice of application for a temporary restraining Order.

Respectfully submitted,

Attorney for Plaintiffs

PLAINTIFFS' MEMORANDUM IN SUPPORT OF PRELIMINARY INJUNCTION, AND IN SUPPORT OF TEMPORARY RESTRAINING ORDER

INTRODUCTION

A quadriplegic Medicaid beneficiary, five pharmacies, two statewide pharmacy member groups, a large independent living center which assists thousands of disabled Medicaid recipients to find care and treatment from Medicaid providers, and the state association of independent living centers who likewise assist thousands of Medicaid recipients to find Medicaid care and treatment,

- (1) challenge the October 27, 2011 action of the defendant Secretary of U.S. Department of Health and Human Services, to approve a State plan amendment ("SPA") of the California Department of Health Care Services (DHCS) for a ten percent Medicaid provider payment cut ("10% rate cut"), not only prospectively, but retroactively to June 1, 2011; and (2) **request (I) a preliminary injunction, with (ii) an immediate temporary restraining order until the hearing of the preliminary injunction motion:** all, to preserve the status quo and prevent the destruction of the Medi-Cal program pending, successively, the hearing of the preliminary injunction motion, and the final determination of this case.

The preliminary basis or predicate for this challenge is that this 10% prospective-and-retroactive rate cut, – whether regarded as a mere 10% rate cut or as the 20% rate cut which in practicality it is, – was enacted in California Assembly Bill (AB) 97 (as amended by AB 102), for purely State budgetary reasons, hence clearly violated the basic procedural requirement of the Medicaid rate-setting statute, which, in the Ninth Circuit, *Orthopaedic Hospital v. Belshe*, 103 F.3d 1491, 1500 (9th Cir. 1997), requires the State's rate-setter to consider the factor of quality of services, and to set payment rates which bear a reasonable relationship to an efficient and economical

provider's costs to provide quality care.[1]

As pointed out by Chief Judge Levi, (now Dean of Duke Law School), in *Clayworth v. Bonta*, 295 F.Supp.2d 1110 (E.D.Cal. 2005, *rv'sd, other grounds*), at 1126:

> The [*Orthopaedic*] court held that Section 30(A) requires the State "to consider the costs of providing . . . services" and that reimbursement rates "should bear a reasonable relationship to an efficient and economical [provider's] costs of providing quality care." *Id.* at 1500. The court reviewed the State's rate setting under an arbitrary and capricious standard.
>
> The *Orthopaedic Hospital* rule is mostly procedural – the state agency must consider the proper factors in developing a reimbursement rate [in the Medicaid program]. Because costs were not considered by the State, the court did not reach the further question of whether the rate was appropriate under Section 30(A).
>
> The Ninth Circuit's approach has substantial practical benefits. . . . Furthermore, it is fair to assume that a rate that is set arbitrarily, without reference to the Section 30(A) requirements, is unlikely to meet the equal access and quality requirements. (Boldface emphasis supplied).

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[1] *Also see*, the prior cases of Plaintiffs' counsel (i.e., *Independent Living Center of Southern California, Inc. v. Shewry*, 543 F.3d 1050 (9t Cir. 2008); and *Maxwell-Jolly v. Independent Living*, 572 F.3d 644 (9th Cir. 2009), affirming preliminary injunctions in *Independent Living v. Shewry*, No. 2:08-cv-3315 CADS (MANx), (C.D.Cal. 2008) and in *Managed Pharmacy Care v. Maxwell-Jolly*, No. 2:09-cv-0382 CAS (MANx), (C.D.Cal, 2009), in which the State legislature was held to violate Section 30A when it reduced rates 10% in 2008, and 5% in 2009, for purely budgetary reasons; and, the same holding, in *Clayworth v. Bonta*, 295 F.Supp.2d 1110 (E.D.Cal. 2003, *rv'sd, other grounds*, 140 Fed.Appx. 677 (9th Cir. 2005), another case of Plaintiffs' counsel.

However, the Secretary has never accepted these views of the Ninth Circuit in *Orthopaedic* or in the *Independent Living* line of cases, that (1) the analysis of a State's setting of provider rates to see if the State has complied with Section 30A is primarily **procedural**, and (2) that the quality of services clause of Section 30A sets a minimum or floor beneath which a State may not set a Medicaid provider payment rate. To the contrary, the Secretary has always contended that efficiency, economy, and quality of care provision of Section 30A only sets an upper limit or ceiling above which a State may not set a Medicaid provider payment rate. *See*, the Solicitor General's brief in opposition to the holdings of *Orthopaedic*, filed when the Director (unsuccessfully) sought certiorari to the Supreme Court, following the Director's defeat in *Orthopaedic*. On Page 9, the SG's amicus brief stated the policy of the Secretary as follows:

> Section 30A requires each state to produce a *result*, not to employ any methodology for getting there, and absent proof that a rate structure results in inadequate access, States may say what they are willing to pay and see whether this brings forth an adequate supply of providers.

Given this background, it is not surprising that CMS, following the Secretary's views which are contrary to the Ninth Circuit's rulings, – which are the law in the Ninth Circuit, – violated Section 30A by approving the 10% rate cut of SB 97. both prospectively and retroactively to June 1, 2011, despite the fact that the enactment of AB 97's 10% rate cut was purely for budgetary reasons.

Therein CMS acted arbitrarily and capriciously, contrary to law, in approving the 10% rate cut, because it applied an incorrect standard for reviewing the action of the State to enact the 10% rate cut, both prospectively and retroactively to June 1, 2011.

I.e., the Ninth Circuit in the *Independent Living* line of decisions, (*Independent Living* v. *Maxwell-Jolly*, 572 F.3d at 654-656), noted the Secretary's above-stated contrary views as to interpretation of Section 30A, and rejected them: we owe the Secretary's views no deference, ruled the Ninth Circuit.

More specifically, the Ninth Circuit ruled:

> (T)he Director also argues that *Orthopaedic Hospital* is no longer good law because its interpretation of § 30(A) "conflicts with the interpretation of the federal agency that Congress vested with the authority to enforce and implement" the statute. By this, the Director apparently means that *Orthopaedic Hospital* conflicts with the interpretation of § 30(A) presented in an amicus brief filed by the Solicitor General when the Supreme Court asked him to opine on whether our decision in *Orthopaedic Hospital* was worthy of a grant of certiorari. In the process of recommending denial of certiorari, the Solicitor General opined that requiring States to reimburse medical providers at rates roughly equal to their costs ran counter to the text and legislative history of § 30(A). From this, the Director concludes that a "federal agency" repudiated our interpretation of § 30(A).
>
> **Whatever the merits of the Solicitor General's views, we owe them no deference in this case.** Although at one time the Supreme Court suggested that a legal opinion expressed by an agency in the course of litigation may be entitled to deference, [citation], it subsequently limited such deference to an agency's interpretations of ambiguities in its own regulations. [Citation]. (572 F.3d at 654). (Boldface emphasis supplied).

The Ninth Circuit then went on in the same *Independent Living* decision to reiterate the Ninth Circuit rule that enacting a Section 30A provider rate cut for purely budgetary reasons, violates Section 30A, and cannot be disregarded in reviewing a State's action to reduce Medicaid provider payments.

Thus *Independent Living* held, 572 F.3d at 655-656:

> First, even those courts that have rejected *Orthopaedic Hospital's* procedural requirements have generally recognized that state Medicaid rates may not be based solely on state budgetary concerns. See *Rite Aid*, 171 F.3d at 856: "(B)udgetary considerations may not be the sole basis for a rate revision . . . "), *see also Beno v. Shalala*, 30 F.3d 1057, 1069 n.30 (9th Cir. 1994) [citations].
>
> In this case, the record supports the district court's conclusion that "the only reason for imposing the cuts was California's current fiscal emergency." The legislation was passed in an emergency session called to "address[] the fiscal emergency declared by the Governor. Thus, quite apart from any procedural requirements established by *Orthopaedic Hospital*, the State's decision to reduce Medi-Cal reimbursement rates based solely on state budgetary concerns violated federal law.

2. Further, because the expressed policy of the Secretary, contrary to the Ninth Circuit, is that costs of providers are not relevant or required to be considered by a State rate-setter, in reducing provider payments, it is manifest that the Secretary failed to review whether the reduced 10% rate would cover costs of providers to furnish quality care, as well as failed to review whether the State considered the costs of providers, (either with or without responsible costs data), in approving the 10%

rate cut on October 27, 2011.

Hence the October 27, 2011 action of the Secretary to approve the 10% rate cut, was clearly erroneous, because the Secretary, – due to her erroneous view that costs of providers are irrelevant, and, that it is irrelevant whether the reduced payments would cover providers' costs, – entirely failed to consider the relevant issue of whether the reduced payment rates under the 10% rate cut would cover providers' costs. Hence the Secretary acted arbitrarily and capriciously, contrary to law, and contrary to the requirements of 5 U.S. Code, sec. 706, in approving the 10% rate cut SPA for providers, including pharmacies, in the Medi-Cal fee-for-service program.

3. **Worse, in respect to pharmacies, the whole issue of whether a 10% payment cut would prevent them from dispensing brands at all, and from dispensing the many high priced generics, by reducing their Medi-Cal reimbursement to below their costs to acquire-and-dispense these drugs, was addressed in suits by Medicaid beneficiaries and pharmacies, (many of them the same as in the within suit), in *Independent Living v. Shewry*, No. 2:08-cv-03315 CJAS (MANx) – a 10% payment cut under AB 5, – and in *Independent Living v. Maxwell-Jolly*, No. 2:09-cv-0382 CAS (MANx), – a 5% payment cut under AB 1183. In these cases the court found on substantial evidence that both a 10% payment cut and even a 5% payment cut would result in pharmacies not being paid their costs to acquire-and-dispense most brands, and many generics; And that many community pharmacies would cease dispensing these prescribed drugs to Medi-Cal patients, or quite the Medi-Cal program entirely.**

Yet the Secretary entirely failed, and in essence refused to consider either these findings of fact, or the evidence upon which they were based, solely because in the erroneous view of the Secretary, such evidence of providers' costs, and that pharmacies would not be reimbursed their costs, under a 10% rate cut, was not relevant.

Therein the action of the Secretary to approve the SPA to allow the State to reduce payments to pharmacies by 10%, prospectively, and also to reduce payments by another 10%, retroactively to June 1, 2011, was clearly arbitrary and capricious, and contrary to law, due to the erroneous view of the Secretary that providers' costs are irrelevant in determining whether a State's payment reduction complies with Section 30A,

Note: The opinion of Richard D. Wilson, C.P.A., in the 10% rate reduction case above cited

by the Plaintiffs, is included in the Schedule of Declarations served and filed herewith. C.P.A. Wilson's findings and conclusions were that under a 10% payment cut, pharmacies in the Medi-Cal program, would have to stop dispensing most brands, and, also, many generics, or, quit the Medi-Cal program entirely. The Wilson declaration, – **as well as the array of declarations filed herewith of the Plaintiffs, (which are contained in the Schedule of Declarations filed herewith)**, – show that unless a TRO and then injunctive relief are promptly issued, that millions of Medi-Cal recipients will become deprived of any access to their brand drugs, and to many generics. This in turn, will cause widespread suffering, return to institutions in order to obtain their medications, for thousands of Medi-Cal recipients, and death for some.

SUMMARY, AND PRAYER FOR PRELIMINARY INJUNCTION AND TRO:

From the foregoing, and for the above reasons, it is clear that the Secretary, acting by and through CMS did, on October 27, 2011, act arbitrarily and capriciously, and in gross abuse of discretion, and not in accordance with law, (namely, contrary to Section 30A), and in excess of and without statutory jurisdiction, to approve the DHCS application for approval of its SPA to permit DHCS and the Director to reduce payment rates to all Medicaid provider in California, including pharmacy providers, by 10%, both prospectively, and retroactive to June 1, 2011.

All this, despite the undisputed fact that the State legislature enacted the 10% rate cut of AB 97, and the Director adopted a policy and decision to implement the 10% rate cut at once, for purely budgetary reasons; and without any consideration of the factor of quality of care as required by Section 30A, or whether providers, including pharmacies, could sustain the 10% rate cut, both prospectively and retroactive to June 1, 2011, without loss of quality of care (contrary to and in violation of Section 30A): all of which was I violation of the Administrative Procedure Act, 5 U.S.C. § 702 et seq., and especially in violation of 5 U.S.C. § 706, subds. (1) and (2)(A), (C), (E) and (F), and in violation of all federal laws and regulations made and provided therefore.

Accordingly, the Plaintiffs pray that (1) a permanent and a preliminary injunction issue,

commanding the Secretary to cause the CMS decision and action of October 27, 2011 to approve the State's SPA for the 10% rate cut to be vacated and set aside in whole and in every part, and that the Director be ordered to refrain form implementing AB 97 or any 10% rate cut or any lesser rate cut, whatsoever or at all, pending the final determination of the within complaint of the Plaintiffs; and (3) that a temporary restraining order issue, ordering the Director and his agents not to implement AB 97 or its 10% rate cut whatsoever or at all, until the court determines the above-mentioned motion of the Plaintiffs for a preliminary injunction; and, for such other and further relief as may be proper.

Dated: November 7, 2011.

Respectfully submitted,

Attorney for Plaintiffs